

economic LETTER

JUNE 2015



A QUICK LOOK AT RECENT TRENDS IN INDUSTRIAL PRODUCT PRICES

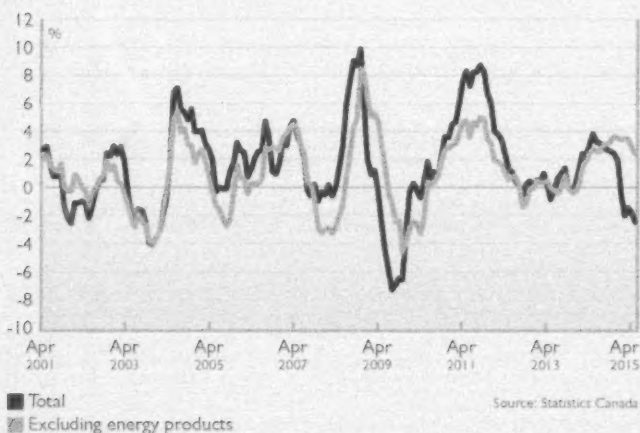
Every month, Statistics Canada calculates an index of the prices that manufacturers receive for their products: the Industrial Product Price Index (IPPI). In this article, we will take a quick look at recent trends in the IPPI and its components. This analysis should be of interest to producers, as it will give them information on how prices have generally evolved in their industry, and to entrepreneurs and consumers, who will gain a better understanding of the price movements of some of the goods they regularly consume.¹

Between April 2014 and April 2015, the IPPI dropped by 2.4%. This downturn is mainly attributable to petroleum product prices, which plummeted by 25.8% during the period. Lower prices for chemical products also contributed to the ▼

Graph 1: The oil price slump drove the IPPI down.

Energy aside, the index is up

(12-month change in the total IPPI and the IPPI excluding energy products, April 2001 to April 2015)



¹ Industrial product prices do not include sales taxes and costs that arise between the moment the product leaves the factory and the time it is purchased by the consumer, such as shipping costs and those related to wholesale and retail trade. A higher price for an industrial product does not necessarily translate into a higher retail price. It can be offset by a slimmer profit margin for the retailer, or a lower shipping cost, for example. Over the long term, though, growth of industrial product prices and that of retail prices more or less follow the same trend.

Canada

- GDP pulls back in the first quarter
- Employment rebounds
- The trade deficit narrows but is still substantial
- The inflation rate heads down

United States

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BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to June 6. Reliance on and use of this information is the reader's responsibility.

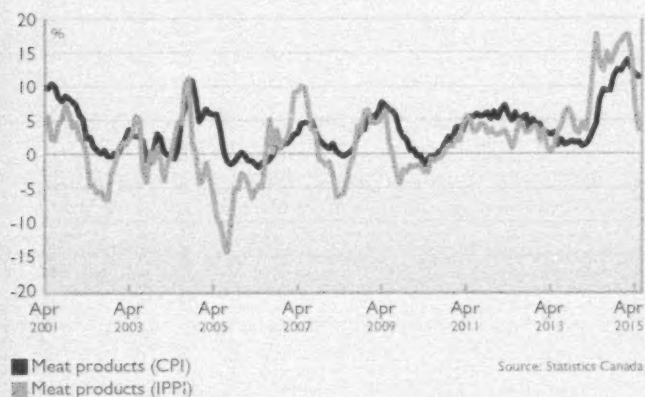
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IPPI's contraction. Price slumps were recorded for chemical products derived from oil, such as petrochemical products and plastic resins. If we exclude energy products, the IPPI rose by 2.4% in April 2015, year-over-year (Graph 1).

In 2014, many components of the IPPI posted substantial price increases. The price of pork shot up by 25.4% and that of beef by 19.9%. Beef prices headed up last year due to contraction in the supply. The southern United States has experienced major droughts in recent years, and pasturelands have suffered, causing a decline in the North American cattle population. Higher pork prices are due in part to higher grain prices, but mainly to the porcine diarrhea epidemic that struck the United States in 2013, reducing the supply. Consequently, prices of meat products—both that received by the producer (IPPI) and that paid by the consumer (CPI)—surged in 2014 (Graph 2). In recent months, though, we have noted a downturn.

Graph 2: Meat product prices rose substantially in 2014

(12-month change in the IPPI and the CPI for meat products, April 2001 to April 2015)



Primary ferrous metal product prices rose by 7.9% after declining by an average of 0.5% per year during the three previous years. Prices of motor vehicles, which had stagnated between 2010 and 2013, headed up in 2014 and accelerated at the beginning of 2015. The sharpest price increases were recorded by motor vehicles and aircraft. Packaging material and container prices also climbed more sharply in 2014 than in previous years.

These price increases are partly due to the depreciation of the Canadian dollar. Manufacturers often quote the prices of the products they export in foreign currencies (mainly the U.S. dollar). Statistics Canada converts those prices into Canadian dollars, generating an increase when the loonie depreciates.² In 2014, the loonie depreciated by 6.8% against the U.S. dollar.

Other industrial products recorded more moderate price increases in 2014, except for two categories where declines were observed. One is "lumber and other wood products," which posted a drop of 0.4%. Experts are predicting that lumber production capacity will expand less quickly than North American demand in 2015, so that the price will head back up.³ Prices have risen by 3.1% in this category since the beginning of the year, in line with those expectations. The other component whose prices fell in 2014 is "fruit, vegetables, feed and other food products." Prices of animal feed and a number of other foodstuffs, such as tea and coffee, declined.

The plunge in oil prices has impacted the IPPI in 2015: the index was down by 1.9% in the first four months of the year, compared with the same period last year. According to forecasters, industrial product prices should dip by 1.2% in 2015.⁴ Energy products aside, though, we can expect accelerated IPPI growth in 2015, as we have seen since the start of the year. ■

² Example: The price of a given product is US\$10.00 in January and remains stable the following month. However, the loonie, which was at parity with the U.S. dollar in January, depreciates by 5% and is worth US\$0.95 in February (so the U.S. dollar is worth C\$1.05 in February). Expressed in Canadian dollars, the price of the product is C\$10.00 in January and C\$10.50 in February, an increase of 5%.

³ Fédération des producteurs forestiers du Québec, «Forêts de chez nous PLU'S», January 1, 2015, vol. 20, no.1.

⁴ Consensus Forecasts, May 11, 2015.

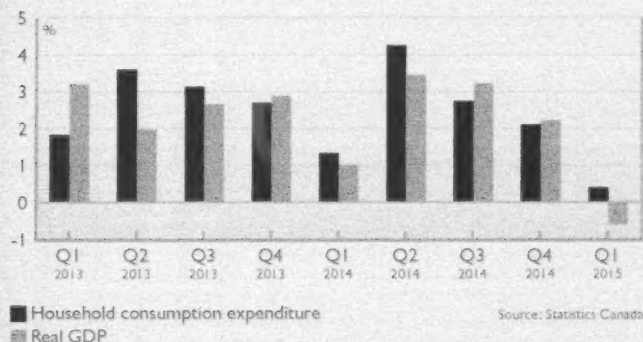
The oil price slump and flagging U.S. demand caused the Canadian economy to weaken in the first quarter of 2015. Growth should rebound in the second quarter, once economic activity picks up steam in the United States and the effects of the oil price slump abate.

GDP pulls back in the first quarter

Real GDP pulled back at an annualized rate of 0.6% in the first quarter of 2015. This is largely attributable to the effects of the oil price slump. Production in the oil and gas extraction sector did not decline during the first quarter, but support activities were slashed by 76%. Meanwhile, consumer spending, which accounts for 55% of real GDP, recorded meagre growth of just 0.4% (graph). It appears that Canadian consumer confidence deteriorated due to the perceived negative impacts of falling oil prices on the economy. The softness of the U.S. economy also contributed to the contraction in Canadian real GDP, as evidenced by the 1.1% drop in exports in the first quarter. Forecasters are expecting growth to rebound in the second quarter, once the effects of the oil price slump fade, and that U.S. economic growth will rally (see section on U.S. GDP).

Consumption growth was very sluggish in the first quarter of 2015

(Household consumer spending and real GDP, annualized quarterly change, Q1 2013 to Q1 2015)



Employment rebounds

After a loss of 19,700 jobs in April, employment rallied in May with an increase of 58,900. There were 30,900 new full-time jobs and 27,900 part-time jobs. The unemployment rate held steady at 6.8%. Job growth was very strong in the service sector. In the goods sector, employment was up in the manufacturing segment only, which posted a solid, second

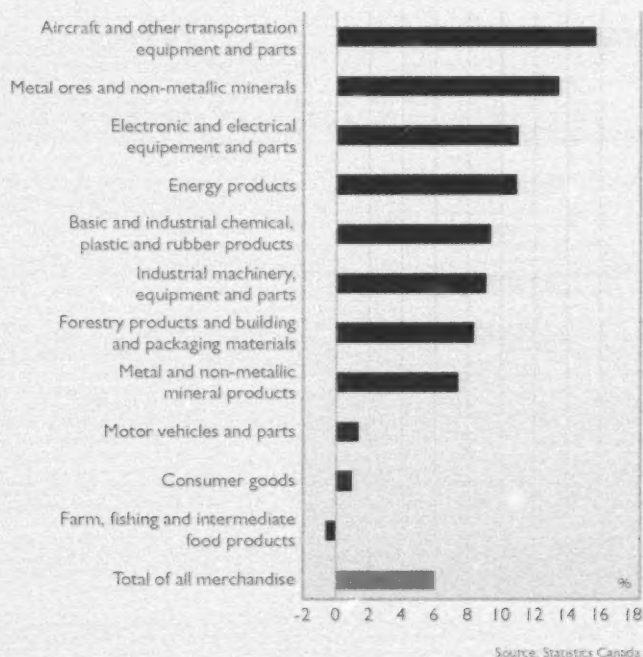
straight monthly gain, recovering the losses sustained at the start of the year. Since the beginning of 2015, the number of jobs has risen by 20,460 per month, on average. This is real progress compared with the average monthly gain of 10,108 seen in 2014.

The trade deficit narrows but is still substantial

Imports declined more than exports did in April (-2.5% versus -0.7%), so that Canada's trade deficit with the world narrowed from \$3.9 billion in March to \$3.0 billion in April, which is still very large from a historical perspective. Exports fell in 7 of the 11 major merchandise categories, including consumer goods (-6.0%) and forest products and building materials (-5.0%). These declines were partly offset by the 5.9% increase in exports of energy products. In terms of volume, imports slipped by 1.8% in April, but exports ticked up by 0.5%. The growth in export volumes since the beginning of the year is still positive and robust in most merchandise categories (graph). ▼

Growth in export volumes remains positive and robust in most merchandise categories

(Volume of exports from January to April 2015 / Volume of exports from January to April 2014)

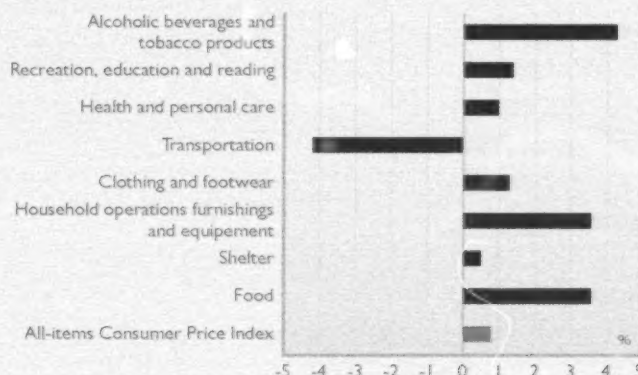


The inflation rate heads down

The inflation rate, as measured by the 12-month change in the Consumer Price Index (CPI), tumbled from 2.0% in April 2014 to 0.8% in April 2015. This decline in inflation is due to the slump in energy prices: during this period, the gasoline price index plunged by 21%, the fuel oil index by 20% and the natural gas index by 15%. The 11% depreciation of the Canadian dollar against its U.S. counterpart during the same period—resulting in higher prices for imported goods—prevented the inflation rate from falling further. For example, the food price index climbed by 3.6% in the past 12 months, since many foods are imported. Of the eight main components of the CPI, the transportation price index (which includes gasoline prices) is the only one to post a decline over 12 months (graph). The shelter cost index, which includes natural gas and fuel oil prices and which is not influenced by the exchange rate, rose the least. ■

The slump in gasoline prices (included in the price of transportation) pulls the inflation rate down

(12-month change in prices of the eight main components of the Consumer Price Index, April 2015)



Source: Statistics Canada

★ UNITED STATES

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Real GDP pulled back in the first quarter of the year. This could be due to the harsh weather conditions, which curbed activity in many sectors. If that is the case, growth should rebound in the second quarter. The housing starts data appear to corroborate this hypothesis: after dropping sharply in the first quarter, they picked up in April.

GDP is revised downward

The Bureau of Economic Analysis in the United States has revised first-quarter real GDP growth for this year downward, from 0.2% to -0.7%. It appears that much of the downturn in economic activity in the first quarter can be attributed to the harsh weather conditions during that period. Consequently, we can look forward to a rebound in growth in the second quarter.

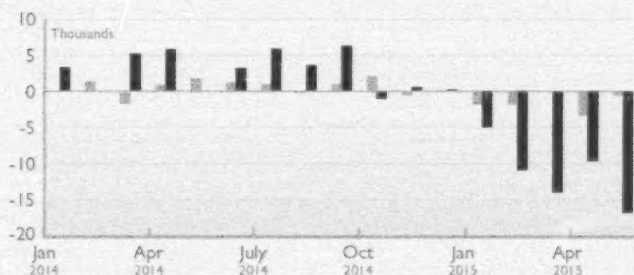
Job growth accelerates

After a two-month slowdown, job growth accelerated in May. The gain of 280,000 jobs recorded in May represents a definite improvement compared with the average monthly change of 202,000 that was recorded in the first four months of the year. The unemployment rate has remained practically unchan-

ged, at 5.5%. Employment expanded in most sectors, and particularly in construction, where 17,000 new jobs were created in May, bringing the gains achieved in that sector over the past 12 months to 273,000. On the other hand, the downward trend continued in the oil extraction sector and that of related support activities (graph). ▼

Employment was down in the oil extraction and support activities sectors

(Monthly change, January 2014 to May 2015)



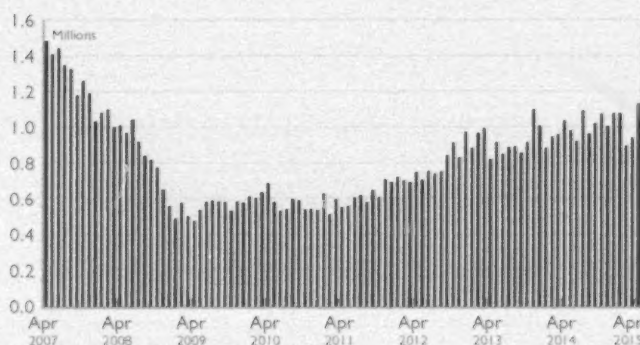
Source: U.S. Bureau of Labor Statistics

Housing starts bounce back

Housing starts shot up by 20.2% in April, reaching 1.135 million units (seasonally adjusted and annualized), their highest level since September 2007 (graph). The single-family home segment was up by 16.7% from the month before, and the multiple-dwelling segment by 31.9%. In the first quarter of 2015, housing starts had declined by 7.6% from the previous quarter; this was attributed, at least in part, to the intensely cold weather, which put a damper on building activity. The April rally seems to confirm this hypothesis. ■

Housing starts rallied in April

(Housing starts, seasonally adjusted and annualized, April 2007 to April 2015)



Source: U.S. Census Bureau



INTEREST RATES

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No change expected in the overnight rate before 2016

On May 27, the Bank of Canada decided to leave the target for the overnight rate unchanged. Since the 25 basis point cut announced in January, the rate has held steady at 0.75%. The central bank expects that the sluggish economic activity observed in the United States in the first quarter will be followed by solid growth in the second quarter, which will help

boost exports and investment in Canada. In general, forecasters are not expecting any hike in the Canadian overnight rate before 2016. On the other hand, despite the sluggish first-quarter economic growth in the United States, expectations of a hike in the federal fund target rate persist: while it now stands within a range of 0% to 0.25%, according to the Consensus Forecast it should reach the level of the Canadian rate by the end of this year, i.e. 0.75%. ■



OIL PRICE

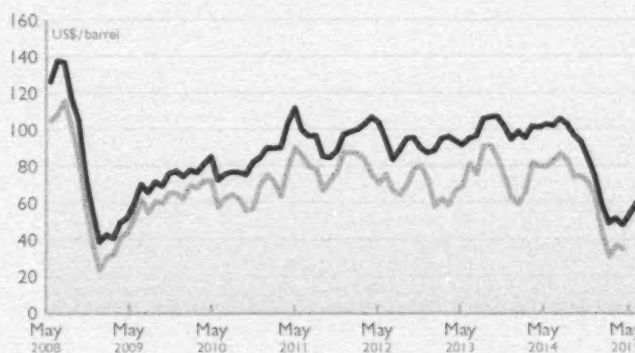
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Crude oil prices keep heading up

The price of crude oil, measured in terms of West Texas Intermediate, rose for the second month in a row in May, winning back some of the ground lost since July 2014. Some observers attribute this upturn in oil prices to downside expectations of production and U.S. inventories and to the expected increase in demand, as the vacation season approaches in the United States. Others think that it is the result of intensifying turmoil in the Middle East, especially in Iraq, Syria and Yemen. ■

Crude oil prices keep heading up

(Crude oil prices, May 2008 to May 2015)



■ West Texas Intermediate
□ Western Canada Select

Sources: Global Insight et Baytex Energy Corp

CANADIAN DOLLAR

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The Canadian dollar continues to gain ground

The Canadian dollar appreciated by 1.2% against the U.S. currency from April to May; this is the second consecutive monthly increase. Rising oil prices no doubt contributed strongly to this development. ■

The Canadian dollar appreciated further in May

(Canada/United States exchange rate, May 2008 to May 2015)



Source: Bank of Canada

SME CONFIDENCE

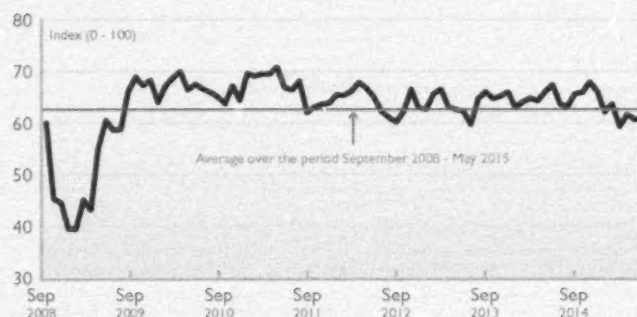
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SME owners' confidence holds steady

The Business Barometer index held steady in May compared with the previous month. At 60.6, it stands slightly below its long-term historic average (graph). The regional numbers have barely changed since April: SME owners in Alberta are still the least optimistic in the country. In terms of sectors, confidence is still very low in the natural resources sector (51.3), which is not surprising in light of the oil price slump. It is more worrisome to note that SME owners in the manufacturing sector are not much more confident (54.9). ■

The Business Barometer index has faltered in recent months but is still close to its long-term average

(Business Barometer Index, September 2008 to May 2015)



Source: Canadian Federation of Independent Business



BUSINESS CREDIT CONDITIONS

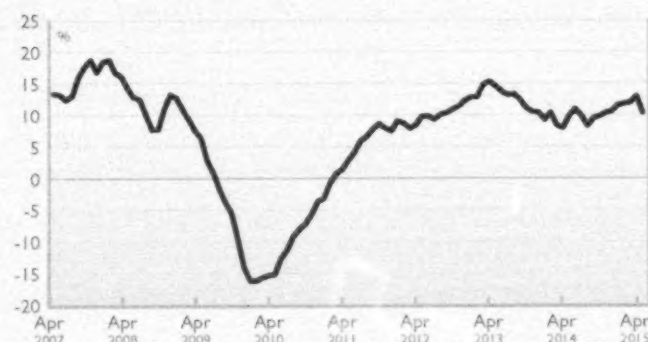
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Bank credit remains stable

Credit granted to businesses by the chartered banks was practically unchanged in April. Short-term credit did not budge, and long-term credit edged up by 0.7%, resulting in an overall bank credit increase of 0.1% compared with the previous month. Annual growth in bank credit fell back in April but was still strong, standing at 11% (graph). ■

Annual growth in bank credit is still strong

(12-month change in credit granted to businesses by the chartered banks, April 2007 to April 2015)



Source: Statistics Canada

KEY INDICATORS—CANADA

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Key indicators—Canada

	Historical ¹				2015 ²				2015		Forecast	
	2011	2012	2013	2014	Q1	Q2	Q3	Q4	Latest ³		2015	2016
Real GDP (% growth)	3.0	1.9	2.0	2.4	-0.6				Mar	-0.2	1.9	2.2
Machinery and Equipment Expenditures (% growth)	8.1	1.9	1.0	1.0	-7.4						-0.6	2.9
Pre-Tax Corporate Profits (% growth)	23.3	-6.7	0.7	10.8	-53.8						-4.7	6.1
Industrial Production (% growth)	4.1	1.4	1.8	4.1	-4.5				Mar	-1.2	1.0	2.0
Industrial Product Prices (% growth)	6.9	1.1	0.4	2.5	-0.2				Apr	-0.9	-1.2	2.2
Non-Residential Construction (% growth)	15.9	13.5	5.0	-0.1	-19.7							
Housing Starts ('000 units)	193	215	188	189	175				May	202	177	177
Personal Expenditures (% growth)	2.2	1.9	2.5	2.7	0.4						2.1	2.1
Consumer Price (% growth)	2.9	1.5	1.0	1.9	-0.2				Apr	-0.1	1.1	2.1
Employment (% growth)	1.5	1.3	1.4	0.6	0.7				May	0.3		
Unemployment Rate (%)	7.5	7.3	7.1	6.9	6.7				May	6.8	6.8	6.7
SMEs Confidence Index (CFIB)	66.3	63.9	63.9	64.9	61.4				May	60.6		
Manufacturers Confidence Index (CFIB)	67.3	66.5	63.8	65.8	61.9				May	54.9		

1. Annual growth rate

2. Quarterly growth, at annual rate

3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.

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